

# **ENFORCEMENT OF SECURED TRANSACTIONS AND BANKRUPTCY NORMS IN BOSNIA AND HERZEGOVINA**

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# **ENFORCEMENT OF SECURED TRANSACTIONS AND BANKRUPTCY NORMS IN BOSNIA AND HERZEGOVINA**

## **INTRODUCTION**

1. In March 2003, International Business & Technical Consultants, Inc. (“IBTCI”) undertook an assessment of the environment for enforcing the rights of creditors to recover on defaulted loans, particularly loans secured by collateral. The IBTCI team considered the enforcement of creditors’ rights in ordinary civil litigation and in bankruptcy proceedings. The team reviewed the relevant laws and conducted a fact-finding to identify the principle problems and concerns confronting secured lenders in Bosnia and Herzegovina today.
2. The IBTCI team’s investigation included interviews with judges, bankers, banking lawyers, debtors’ lawyers, court-appointed property value appraisers, and representatives of the bankers’ associations.<sup>1</sup> The interviewees had substantial experience with creditor-initiated litigation, and included individuals with experience in bankruptcy proceedings. The team met with individuals who have conducted and/or participated in training programs for judges and lawyers in Bosnia and Herzegovina, and with members of the international community involved in current law reform efforts in the relevant legal areas. The team also met with members of the business community involved in internet-based business initiatives.
3. The team undertook to determine the extent to which relevant stakeholders and participants in the enforcement process understand and apply the relevant laws, to identify the barriers to effective enforcement, and to assess the problems requiring immediate attention. The results of the team’s assessment are set forth below.

## **BACKGROUND**

### **The Progress of Commercial Law Reform**

4. For the last several years, frustration has grown over the lack of progress in improving the business environment in Bosnia and Herzegovina. Several studies, one by the International Crisis Group, and another by the Financial Investment Advisory Service have outlined numerous obstacles to sustainable economic growth. Among the problems identified were (1) a court system unable to resolve commercial disputes in a relatively swift and predictable manner (2) a non-functioning bankruptcy regime, and (3) the absence of an efficient process for enforcing security interests in property.
5. The Office of the High Representative has recognized the deleterious effects of these shortfalls:

Investors and banks cannot collect debts and enforce contracts through the courts. A huge backlog of cases has accumulated, undermining existing business and discouraging new private investment and the opening up of new investment opportunities.

*See Office of the High Representative, Making Bosnia Work – Phase II –Building a Business-Friendly Economy (Draft, March 19, 2003).*

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<sup>1</sup> See Appendix 1 for list of individuals consulted.

## Recent Reform Efforts

6. In recognition of these problems, the governments of the respective Entities, as well as the international community, have redoubled reform efforts. Particular attention has focused on improving the framework for resolving commercial disputes. The court system in each Entity is undergoing a significant reorganization. The number of first instance judges will be reduced from 654 to 492 by the end of 2003. These judges will hold proceedings at 19 courts in the Republika Srpska ("RS") and 27 courts in the Federation of Bosnia and Herzegovina ("Federation"). The judges that remain (including the new president of each court) and any new appointees will have gone through a vetting and reappointment process designed to weed out corrupt and/or incompetent judges.<sup>2</sup> Overall management of these courts (their funding and monitoring) will shift from the ministries of justice to the High Judicial and Prosecutorial Council ("HJPC") over the next eighteen months. The extent of the influence that the ministries of justice will retain remains unclear.

7. Proceedings in the first instance courts are expected to be governed by a new Code of Civil Procedure. Judgments of the courts are likely to be enforced in accordance with a new Law on Enforcement Procedure.<sup>3</sup> Both laws, which are expected to be passed in the second quarter of 2003, will streamline procedures for enforcing secured and unsecured obligations.

8. Further, within selected first instance courts, fifteen commercial divisions will be established, corresponding to the ten cantons in the Federation and five districts in the RS.<sup>4</sup> While remaining within the organizational framework of the first instance courts, and sitting in the same offices as other first instance judges, the judges in the commercial divisions will hear cases concerning, *inter alia*, bankruptcy, business contracts, commercial real estate, and intellectual property. This specialization should accelerate their accumulation of knowledge and experience in these matters.

9. Reforms are under way to reduce substantive legal uncertainty with respect to property rights and secured transactions. A new land registry law was enacted in both Entities in October 2002. Modernized land registries are expected to be opened in Sarajevo in the second half of 2003 and then in the rest of the country by early 2004. A new law on registered pledges in movable property was passed in both Entities, and a centralized pledge registry for recording such interests is expected to open by early 2004. A new law on notaries (passed in the Federation and under consideration in the RS) will allow parties to enter into more easily enforced, executory agreements with respect to loan obligations.<sup>5</sup> A working group on a new property law (which, among other things, will clarify the rights of mortgagees) is expected to convene in the next two months.

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<sup>2</sup> See generally, Independent Judicial Commission, *Restructuring The Court System: Report And Proposal* (August 15 2002).

<sup>3</sup> Just last week, on April 30, 2003, the new Law on Enforcement Procedure was passed in the RS. The official text of the new law is not yet available. The same law is currently pending before the Federation legislature.

<sup>4</sup> The number of judges to be designated to serve in a particular commercial division will depend on the expected commercial case volume in the particular district or canton. The commercial divisions in Sarajevo and Banja Luka, for instance, will likely have several more judges than the commercial divisions in the rural cantons and districts.

<sup>5</sup> Currently, these agreements, which obviate the need for full litigation in the event of a loan default, may be entered into only after a proceeding before the court. With the expected training and licensing of notaries in the near future, notary-created executory agreements will become an alternative means of accessing summary procedures in the event of a loan default.

10. Bankruptcy procedures have also been the subject of intense reform efforts. On January 1, 2003, a new bankruptcy law came into effect in the RS, and the Federation enacted a similar law on April 30, 2003..<sup>6</sup> The new legislation closely regulates bankruptcy proceedings, establishing strict deadlines for the courts to process cases.

11. In addition to these efforts, the “Bulldozer Committee”, a partnership between the business and international communities, has developed fifty recommendations for economic reforms directed at removing “pointless bureaucratic barriers to doing business in Bosnia and Herzegovina.” The areas targeted by the initiative include tax, labor, trade, business registration, finance, and transport. The Bulldozer Committee has challenged the legislature of each Entity to enact these reforms in the next several months.

### **The Need for Effective Implementation**

12. Despite this progress, significant challenges remain in implementing the recent economic reforms.

13. With respect to court procedures, judges, clerks, enforcement officers, and other support personnel in the first instance courts need to be trained, equipped and reoriented, with their subsequent performance closely monitored. The courts need to embrace standards of efficiency, transparency, and customer service significantly above the standards that have currently resulted in a backlog of tens of thousands of cases.

14. But while the empowerment and training of court personnel is important, it is also necessary to broaden the knowledge and confidence of business people and other beneficiaries of these laws in order to allow them to police the activities of judges, attorneys and other court personnel. To the extent possible, implementation should be standardized and demystified through the development of forms, manuals and guides. Much of this information could be placed on the Internet in order to ensure that the information is up to date and distributed on a cost-effective basis.

15. Two particular aspects of commercial law enforcement deserve special attention. First, in order to encourage further lending, the court system must be capable and willing to enforce claims secured by pledges or mortgages of property in the event of a loan or contract default. Second, when companies (especially ones that remain state owned) come under bankruptcy proceedings, the courts need to show the skill and political courage to bring these matters to a conclusion, protecting the rights of legitimate stakeholders (primarily creditors) along the way.

### **Assessment of the Environment for Enforcement of Creditors’ Rights**

16. Set forth below is an assessment of the legal and business environment in Bosnia and Herzegovina as it relates to the enforcement of creditors’ rights both within and outside of the bankruptcy context. Section I relates to the enforcement of creditors’ rights in mortgages and other collateral; Section II addresses bankruptcy; and Section III discusses the role the business community has played (and should play) in furthering commercial and judicial reforms.

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<sup>6</sup> The official text of the new law is not yet available.

## **THE ENVIRONMENT FOR ENFORCING OBLIGATIONS SECURED BY REAL PROPERTY AND OTHER COLLATERAL**

17. In late 2000, reports issued by the Foreign Investment Advisory Service, the European Bank for Reconstruction and Development, the International Crisis Group and others identified significant barriers to the effective enforcement of mortgages, as well as the absence of a mechanism for registering security interests in movable property. These problems exist today. Banks continue to face significant hurdles when seeking to recover on loans after a borrower's default, even with respect to loans that are secured by mortgages on real property. Banking lawyers understand that it can take two to three years to litigate a straight-forward collection case based on an unambiguous, fully secured loan agreement, and it is common for a creditor to reach the end of the proceeding without having actually recovered the outstanding debt.<sup>7</sup>

18. The major problems with enforcement are: (a) the absence of functioning land and pledge registries; (b) poorly equipped courts; (c) the reliance upon a small group of over-burdened "enforcement judges" in each court to handle the enforcement of all civil judgments as well as all mortgages and pledges; (d) judges who are not oriented toward the needs and values of a market economy, are overly debtor protective and tolerate inordinate procedural delays; (e) enforcement procedures that are heavily dependent on property value appraisals that bear little or no relationship to fair market value; (f) extremely cumbersome, time-consuming enforcement procedures mandated by statute; and (g) illiquid and non-transparent markets for real and movable property.

19. Reform efforts are currently underway. The big challenge will be to make the reforms work. Discussed below are the current legal environment and its most pressing problems, the reforms underway, and the measures needed to effectuate them.

### **Current Legal Framework**

#### **Creation of Mortgages and Pledges**

20. Mortgages and pledges are created by the execution of a written agreement embodying a loan or other obligation and identifying the security being provided, and the registration of the mortgage or pledge with the appropriate authority. The agreement is typically executed before a judge, who issues a decree proclaiming the agreement enforceable. Execution in this fashion entitles the creditor to go directly to an "enforcement procedure" in the event of a breach, without having to first obtain a judgment through a full-blown civil litigation under the Code of Civil Procedure.<sup>8</sup>

21. The law governing the creation of mortgages on real property is derived from the SFRY Law on Legal-Property Rights, which, with respect to mortgages, contains a total of seven highly generalized provisions.<sup>9</sup> The law provides that mortgages become effective upon being recorded in the applicable land book or public registry "or other ways provided by law," and that a creditor whose claim is secured by a mortgage is entitled to priority over the claims of unsecured creditors and creditors with subsequently established mortgages.

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<sup>7</sup> Bankers in the RS describe somewhat shorter delays than do their counterparts in the Federation.

<sup>8</sup> See Law on Enforcement Procedure, (SFRY Official Gazette No. 20/78, as amended, Nos. 6/82, 74/87, 57/89, 20/90, 27/90, 35/91), Art. 16.

<sup>9</sup> Law on Legal-Property Relations, (Federation Official Gazette No. 6/98), Arts. 68-74; SFRY Law on Property Relations, (SFRY Official Gazette No. 6/80, as amended, Official Gazette No. 36/90), adopted by the RS, Arts. 61-69.

22. The law as it existed in the SFRY provided only two means of obtaining a pledge over movable property: the possessory pledge – essentially a pawn arrangement – set out in the Law on Obligations,<sup>10</sup> and a mechanism under the Law on Enforcement Procedure providing for the creation of a pledge by agreement registered with the court.<sup>11</sup> The court records were not electronic and not easily searchable. Each court maintained separate pledge records and there was no centralized search mechanism.

23. A new pledge law was recently enacted in both Entities.<sup>12</sup> The law provides for a publicly searchable, fully transparent electronic pledge registry with a single centralized database in each entity. The pledge registry does not yet exist, however, and the law has not yet been applied. The new pledge law is a major improvement upon the prior law, although its benefits will not be felt until the corresponding pledge registry is established and functioning. As discussed below, by the time this occurs, the current law may be replaced by a more comprehensive pledge law currently being drafted by the USAID Pledge Registry Project.

### **Enforcement of Mortgages and Pledges.**

24. The enforcement of mortgages and pledges has been governed to date, in both the Federation and the RS, by the SFRY Law on Enforcement Procedure.<sup>13</sup> The law applies to the enforcement of legal obligations that either have been reduced to judgment through a prior civil litigation under the Code of Civil Procedure, or are embodied within certain specified categories of “enforceable documents” such as agreements executed before a judge, as described above. Upon breach of such an agreement, the aggrieved party bypasses the normal civil litigation procedure and goes directly to an enforcement judge to recover against the agreed-upon collateral or from other assets of the debtor.

25. An essential step in an enforcement proceeding is the appraisal of the property being seized or sold in foreclosure. A court “expert” assesses the presumed value of the property. The Law on Enforcement Procedure currently provides that at the first foreclosure sale, the property can be sold for no less than 100% of the appraised value. If the property is not sold at the first sale, the creditor can petition the court to hold a second sale. At the second sale, real property can be sold for no less than 2/3 of the appraised value and movables can be sold for no less than 1/3 of the appraised value. For moveable property, the proceeding is dismissed if the property is not sold at the

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<sup>10</sup> This mechanism requires the debtor to deliver the pledged property to the creditor. *See* Law on Obligations (SFRY Official Gazette, No: 29/78, amended in No: 57/89, carried over in BiH legislation with amendments (BiH Official Gazette, No: 02/92)), Chapter XXVIII, concerning “Security Upon Personal Property.”

<sup>11</sup> Law on Enforcement Procedure, Art. 247. Additionally, it is possible to register pledges of securities in the respective share registries located in each Entity. *See* Federation Law on Securities (Federation Official Gazette Nos. 39/98 and 36/99), Arts. 39-41 and Rules of the RS Securities Commission, Arts. 28-33. These registries are centralized, publicly accessible and easily searchable. However, because shares are not commonly accepted as collateral, the registries are not often used for the pledge of shares.

<sup>12</sup> Law on Pledges on Movables and Rights (Federation Official Gazette, No. 17/02; RS Official Gazette No. 16/00, as amended, RS Official Gazette, No. 52/2001). The Entities’ respective laws provide for the law to become applicable in May 2003 in the Federation and June 2002 in the RS.

<sup>13</sup> The law is sometimes translated into English as the “Law on Executive Procedure,” and the judges responsible for enforcement proceedings are called either “enforcement judges” or “executive judges.” The new Law on Enforcement Procedure just passed last week in the RS is discussed in section III (C), below.

second sale. For real property, a third sale can be held, but the minimum sale price remains 2/3 of the appraised value.

## **Current Problems**

26. The problems plaguing the enforcement of mortgages and pledges stem from both legal and market factors.

27. On the legal side, bankers and banking lawyers point to the absence of viable land and pledge registries as well as the inefficiency and ineffectiveness of the enforcement proceedings.

28. The land registration system was largely destroyed during the Second World War, and many land books were lost or destroyed in the recent conflict. Many are incomplete. Their accuracy is further compromised by property owners failing to file their interests for tax-avoidance reasons. Mortgage lenders must search the land books, cadastres (which reflect current possession but not chain of ownership), and other records in an attempt to identify those with rights on particular parcels of real property, but cannot establish with certainty all the interests that may exist. The land registries are chaotic, and in some places it is time consuming to file with the registry.

29. Similarly, the lack of centralized, publicly searchable pledge registry makes it impossible to establish whether a particular piece of property is covered by a pre-existing pledge. For this reason, bankers report that pledges on movable property provide extremely limited security.

30. With respect to enforcement, there is broad consensus, even among some judges, that the Law on Enforcement Procedure is too debtor-friendly. The principle problems with the existing law are the following:

- Debtors can avoid or delay the proceedings by avoiding service of process, seeking postponement of the proceedings, or seeking interlocutory appeals which stay the enforcement process;
- Debtors can avoid enforcement against movable property by moving or hiding the property upon receiving notice that an enforcement proceeding has been commenced; and
- The majority of foreclosure sales fail because the minimum allowable sale price is generally set too high due to court-ordered appraisals that have little or no relationship to market value.

31. The appraisal problem was raised by every banking lawyer interviewed. The appraisals are conducted by “experts” approved by the ministries of justice and selected by the enforcement judges for particular cases. The experts selected by judges for these proceedings typically are civil engineers by training, or experts in construction. They are not trained as property appraisers and generally are not trained in economics. Typically, the court experts calculate value by estimating the construction costs associated with building on the real property, or constructing the movable property, at



issue.<sup>14</sup> The result is that the appraised value typically exceeds the price at which the property can be sold in the market.<sup>15</sup>

32. The appraised value is often so inflated that even at 2/3 or 1/3 of the appraised value, the property cannot be sold. Under the current Law on Enforcement Procedure, the foreclosure sales frequently fail because the property cannot be sold at the statutorily set minimum price.

33. With respect to the courts, the view routinely expressed by members of the banking community is that judges do not understand market principles, are predisposed to favor protection of debtors over enforcement of creditors' rights, and tolerate inordinate procedural delays.

34. While the attitudes of many judges are surely responsible for many of the problems that creditors currently face, a major component of this problem also relates to the way in which enforcement proceedings are handled by the courts. In each court, a few judges are assigned responsibility for enforcing all civil judgments entered in their respective courts, in commercial and non-commercial matters alike, in addition to enforcing all mortgages and pledges.

35. In some courts, three judges enforce the judgments rendered by as many as fifteen other judges, or more.<sup>16</sup> This allocation may have made sense in a socialist economy where secured lending was limited and state-owned enterprises were on both sides of many transactions. It does not necessarily make sense today. The burden on the enforcement judges is huge, and the backlog of enforcement proceedings on their dockets is staggering.

36. The courts are poorly equipped to handle the matters before them. Even in major cities, some judges lack computers – let alone internet access, email, or easy access to new laws or the secondary sources that would help judges understand how to apply them.<sup>17</sup>

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<sup>14</sup> One banking lawyer explained that in certain remote rural areas, where the cost of transporting construction materials to a construction site exceeds the costs of transporting the materials within a city, the appraised value of real property is sometimes set *higher* than the appraised value of comparable property in a city, even though the latter would sell for a much higher price in the market.

<sup>15</sup> Bankers themselves may contribute to the problem by accepting inflated appraisals of collateral at the time a loan is made. Bankers have reported that it is common practice for the debtor to select and pay the appraiser. The appraiser's fee is often set as a percentage of the appraised value, so higher appraisals yield higher fees. These appraisals can be as unrealistic as the appraisals conducted in the enforcement proceedings. One enforcement judge said that banks' challenges to court-ordered appraisals are undermined when the underlying loan agreement incorporates an appraisal similar to the appraisal conducted by the court expert. While the ultimate decision as to which appraisal should be incorporated into the "enforceable document" rests with the judge before whom the agreement is executed, (see para. 20 above), banks have the opportunity to present their appraisal at the time of execution.

<sup>16</sup> In Sarajevo Municipal Court 1, for example, the Enforcement Department consists of three judges, three referees and three enforcement officers to enforce the judgments entered by all of the other judges in the court. The judge in charge of the Department reported that the size of the Department is unchanged from what it has been for more than a decade, even though the number of enforcement proceedings has increased markedly.

<sup>17</sup> Each of the two Judges the IBTCI team visited in the Municipal Court in Banja Luka had one telephone and one typewriter, which they shared with their secretaries. Although some departments within the courthouse have shared computers, the judges handling enforcement proceedings and bankruptcy do not. There is currently one functioning photocopier for the entire courthouse, and a second copier that works intermittently.

37. Current market conditions compound the legal problems. Markets for real and movable property, particularly property sold in foreclosure, are highly illiquid. This is partly a function of cultural norms that disincline individuals to purchase property from neighbors in financial distress, particularly in smaller communities where neighbors know one another. There is also some suggestion that a sense of intimidation may further deter individuals from purchasing foreclosed property owned by powerful individuals or businesses.

38. Moreover, the markets are non-transparent. Information concerning property sale prices is currently difficult to obtain, and the lack of transparency hinders market development.

39. Finally, the enforcement problems described above keep buyers out of the market, which further hampers liquidity.

### Reforms Under Way

40. A new land registry law, drafted with the help of GTZ,<sup>18</sup> was imposed on both Entities by the High Representative on October 21, 2002.<sup>19</sup> GTZ is assisting in the development of the land registry, and expects that a pilot registry will be open in Sarajevo during the summer of 2003, with the new land registry system in place throughout Bosnia and Herzegovina by early 2004. GTZ will also be providing assistance on the drafting of a new law governing mortgages and other rights in real property in the near future.

41. The USAID Pledge Registry Project is creating a modern, electronic pledge registry, which it expects to have operational by early 2004. The Project also is currently drafting a new pledge law to address the omissions in the current law, and hopes that the new law will be in effect by the time the registry is established.<sup>20</sup>

42. A new Law on Enforcement Procedure drafted by a working group organized by the Independent Judicial Commission (IJC) was sent to both Entity Parliaments in April 2003. The law was passed in the RS on April 30, 2003, and is expected to be passed in the Federation in the near term. To address the most egregious problems with the existing law, the new law will:

- *Expedite the enforcement process.* To accomplish this, the law sets short time frames for the parties to submit their positions and for the court to rule. It also

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<sup>18</sup> GTZ is the acronym for the German agency for international assistance, *Deutsche Gesellschaft für Technische Zusammenarbeit*.

<sup>19</sup> Law on Land Registry in the Federation (Federation Official Gazette 58/02); Law on Land Registry in the RS (RS Official Gazette 74/2002).

<sup>20</sup> The current pledge law improves markedly upon the prior law, but is flawed. For instance, while it makes possible the use of floating liens over inventory, the law does not distinguish between ordinary course sales of inventory and business sales. A consumer purchasing an ordinary consumer product would therefore have to check the pledge registry to see whether the seller's inventory was subject to a pre-existing pledge, and if so, would risk forfeiting the product purchased in the event of a dispute between the seller and a secured creditor. Law on Pledges on Movable and Rights (FBiH Official Gazette, No. 17/02; Official Gazette of the RS, No. 16/00, as amended, RS Official Gazette, No. 52/2001). Similarly, the law provides that a judgment lien created by court ruling has priority over a subsequently registered pledge, without regard to whether the lien was registered or whether the subsequent secured creditor had notice of the lien. *Id.*, at Art. 11 (2)). Its most pressing omission is its failure to simplify the mechanisms for enforcing a pledge right.

eliminates most interlocutory appeals, and expands the means of accomplishing effective service.

- *Eliminate the former practice of permitting debtors to delay a foreclosure sale by raising challenges to the sale.* The new law provides that the foreclosure sale shall proceed notwithstanding most debtor objections or appeals. Such challenges may be brought after the fact to recover damages from creditors for wrongful sales or other misconduct, but in most instances, the sale cannot be delayed on account of them. The new law also eliminates most of the previously existing bases by which a debtor could seek to void after the fact the sale to a third party.
- *Remove obstacles concerning appraisals.* The new law reduces the minimum required sales prices and allows a final sale with no minimum price.<sup>21</sup> Accordingly, under the new law, unrealistically high property appraisals can have the effect of delaying a successful foreclosure sale, but they will no longer provide a basis for precluding a sale.

43. The new law empowers judges to enjoin some of the abusive practices debtors have employed to date.<sup>22</sup> It also contains provisions that leave room for discretion, and have the potential, if misapplied, to become loopholes that debtors can exploit for delay.<sup>23</sup>

44. The new law also expands the category of “enforceable documents” to include those executed before a notary, without the necessity of appearing before a judge. As noted above, notaries currently do not exist in Bosnia and Herzegovina, but GTZ plans to conduct training and certification of notaries this year.

45. Finally, as noted earlier, the courts are being restructured with the establishment of commercial divisions throughout the country. These divisions, however, will not have responsibility for enforcing mortgages and pledges, as this will continue be handled only by enforcement judges. The reorganization does not contemplate the appointment of enforcement judges specializing in commercial cases.

## **Making the Reforms Work**

46. The legal environment for enforcing mortgages and pledges will undergo substantial changes within a short period. These will require a shift away from the pro-debtor biases of the public and the courts, who must be educated as to why the reforms are important for economic development.

47. Private stakeholders should be encouraged and enabled to participate meaningfully in on-going reform efforts. It will be crucial to get local buy-in so that the reforms that appear on paper are effectuated in practice.

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<sup>21</sup> For real property, the minimum price is 1/2 and 1/3 of the appraised value at the first and second sale, and no minimum price for the third sale. For movable property, the minimum price at the first sale is 1/2 the appraised value, and a second sale can proceed without a minimum price. (RS Law on Enforcement Procedure, March 2003 Draft, Arts. 89(1) & (2), 90(5) & 131(1)). The law provides further that, under some circumstances, by agreement executed prior to the enforcement proceeding and certified by the court, the parties can lower the minimum price for the first sale of real property to 1/3 the appraised value. *Id.*, at Art. 89(8).

<sup>22</sup> For example, the law empowers judges to enjoin debtors from damaging collateral in their possession, and to disclose the identity and location of assets.

<sup>23</sup> For example, the new law provides for the possibility of nullifying a foreclosure sale where the debtor has missed certain filing deadlines under circumstances that suggest that such failure should be excused.

48. The legislative changes must be monitored and coordinated to ensure that the new laws are mutually consistent and operate effectively together. The new laws and institutions will have to be reviewed and adjusted to address any problems that arise after they have taken effect.

49. The increasing demands upon the courts and registries have to be anticipated and provided for.

50. The following measures would help maximize the effectiveness of the current reforms:

### **Ensuring Adequate Capacity of the Enforcement Departments of the Courts**

51. The HJPC should establish a system for monitoring the efficiency and effectiveness of the first instance courts, and for anticipating and coping with systemic challenges, particularly in the enforcement process. The backlog of enforcement proceedings must be managed. Additionally, the demands upon enforcement judges under the new Law on Enforcement Procedure, particularly in light of the hoped-for increase in collateralized lending, must be anticipated and addressed.

### **Judicial Training and Support**

52. Judges in the 15 commercial divisions, and the enforcement judges in each court must be trained, equipped and incentivized to succeed. Enforcement judges should be trained on the new Enforcement Law, and commercial and enforcement judges will require substantial training on the application of the new pledge law<sup>24</sup> and any new mortgage law, and the use of the land and pledge registries. Training should explain the importance of the new laws to economic development.

53. HJPC and the relevant judicial authorities should:

- arrange for intensive training sessions for enforcement judges on the new Law on Enforcement Procedure, the pledge law (or its replacement) and any new mortgage law;
- develop a core curriculum that emphasizes interactive, case-oriented teaching methods that (i) facilitate predictable and expeditious enforcement of contractual obligations, (ii) effectively address any provisions in the new law that could become bases for delay or avoidance of contractual obligations, (iii) explain the rights of secured lenders vis-à-vis unsecured creditors and each other; (iv) prepare the judges for expected changes in the laws relevant to enforcement of mortgages and pledges; and (v) explain the significance of effective enforcement of creditors' rights for economic development; and
- ensure that enforcement and commercial judges all have computers, internet access and other basic material support.

### **Training for Court Officials**

54. Court referees and other court officials involved with enforcement need training on the practical aspects of seizing and selling property under the new Law on Enforcement Procedure, the pledge law (or its replacement) and any new mortgage law.

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<sup>24</sup> If a new pledge law is not passed in the near term, training will be necessary on the recently promulgated pledge law, even if it will eventually be replaced.

### **Development of Qualified Property Appraisers**

55. With respect to property appraisers, the following is required:

- Court experts who are involved in enforcement proceeding appraisals should be trained on property appraisal methods that emphasize market value as the basis for property appraisals, utilizing interactive, case-oriented teaching methods.
- Other individuals who could serve as appraisers should be identified, possibly with the assistance of local bankers, the banking association, the chamber of commerce and the courts, and should be trained as described above.
- An examination should be developed to test graduates of the training program and to certify those who have achieved a level of proficiency sufficient to qualify them as court experts.
- An association of qualified appraisers should be developed, to promote and facilitate education, certification and the sharing of information concerning appraisal methods, current market conditions, and property sales prices.

### **Increasing Transparency of Property Sales**

56. The transparency of property sales and the accessibility of sales price information should be increased and supported by encouraging local stakeholders (e.g., bankers) to publish such information on a publicly accessible website. The website should help stakeholders to identify effective appraisers by indicating with respect to property sales, the appraised value and actual sale price, along with the identity of the relevant appraiser. This information should also be published in hard copy so that it is accessible to those lacking Internet access.

### **Promoting Effective Land and Pledge Registration Systems**

57. The opening of the land and pledge registries should be accompanied by a public education campaign. The campaign should explain the function of the registries, and encourage real property owners to register their interests.

58. The operation of the registries should be monitored so that inefficiencies and disincentives to registration are identified and addressed.

59. Registry officials need to be trained. Training should focus not only on the proper functioning of the registry, but also should encourage efficiency, transparency and user-friendly service.

### **Promoting Transparency Concerning Judicial Performance**

60. Judges should be required to publish their results (e.g., decisions, data reflecting the number of cases disposed of each year, etc.).

### **Ongoing Law Reform**

61. The development of pledge and land registries and of the new laws on mortgage and pledges should be tracked, and problems with implementation should be identified and anticipated.

62. The proposed new pledge and mortgage laws should rectify the continuing problems associated with the enforcement procedures under the new Law on Enforcement Procedure, by providing for streamlined procedures to apply to the foreclosure of mortgages and pledges.

63. The HJPC and other relevant authorities need to anticipate and address the administrative burdens that the changes in the laws on mortgages and pledges are likely to impose on the courts, and to ensure that the enforcement judges and the judges in the commercial divisions are apprised of the proposed changes in the laws and of the newly promulgated legislation. Bankers and other relevant stakeholders should be encouraged to become actively involved in commenting upon drafts.

### **Development of Civil Society**

64. Private stakeholders – particularly the banking community – need to work together to advance mutual interests.

- They should take an active role in shaping legislation by commenting upon early drafts of proposed new laws and by initiating requests for amendments to existing and new legislation as may become necessary.
- They should actively change disadvantageous business practices, such as the current practice of accepting inflated appraisals of collateral at the time loans are made. They should accept appraisals only from qualified, market-oriented appraisers.
- They should advocate to expand the pool of commercial and enforcement judges to include lawyers with market economic business experience, and should propose candidates to fill judicial vacancies as they occur.
- They should improve transparency in property sales by sharing and posting sale and price information.

### **Expanding the Pool of Judges with Commercial Expertise**

65. On a going-forward basis, the pool of judges should be expanded to include lawyers with business experience and commercial law expertise.

### **Education of Law Students**

66. The materials developed for the trainings described above should be adapted for use as teaching and reference materials for use in law schools.

## **IMPLEMENTATION OF BANKRUPTCY NORMS**

### **The Overall Bankruptcy Regime**

67. An effective bankruptcy regime supports economic growth in two fundamental ways. First, it encourages more lending by providing greater certainty to creditors that their claims will be treated fairly when an enterprise comes under economic stress. Second, it liberates otherwise productive assets trapped in non-functioning or semi-functioning enterprises. It does this by either reinvigorating the enterprise through rehabilitation/reorganization or by moving the assets to a third party through liquidation.

68. When ineffective, a bankruptcy regime erodes creditor confidence in lending to any but the most financially healthy enterprises. When enterprises do come under financial distress, ineffective bankruptcy systems usually aggravate rather than resolve the problem. The unhappy result is often a judicial limbo, where creditors in a bankruptcy proceeding can neither enforce their claims (due to a judicially imposed stay of enforcement rights) nor force a decision as to the debtor enterprise's fate.

69. As discussed more fully below, assistance will be required in implementing the new bankruptcy law. It is likely that, for the immediate future, most of the large enterprises coming under bankruptcy proceedings will be at least partially state owned. Assistance should be tailored to these enterprises.

### **Background**

70. Although statistics on enterprise insolvency provide only limited information,<sup>25</sup> there is a broad perception that many enterprises in Bosnia and Herzegovina are unable to pay their debts as they fall due. A substantial portion of the larger insolvent enterprises are at least partially state owned.

71. In many cases, the largest creditors against insolvent enterprises are the tax authorities. It is estimated that half of 400 million KM due the tax authorities in the Federation is owed by state and socially owned enterprises. Most of these debtors, according to one tax official, are insolvent.<sup>26</sup>

### **Relevant Laws**

72. The authority to enact bankruptcy legislation lies with the Entities. In the latter half of 2002, the RS passed the Law on Bankruptcy Proceedings<sup>27</sup> and the Law on Liquidation.<sup>28</sup> Both laws came into effect on January 1, 2003. Similar legislation was passed in the Federation last week. Unless otherwise indicated, the “Law on Bankruptcy Proceedings” (or simply “the Law”) will refer to the legislation passed in both Entities.

73. The Law on Bankruptcy Proceedings governs cases where a debtor is insolvent. The Law on Liquidation governs situations where a solvent company is winding up its operations.<sup>29</sup>

74. Spanning over 230 articles, the Law on Bankruptcy Proceedings provides for comprehensive regulation of the bankruptcy process. Its procedures, in the simplest terms, could be described as follows:

- A debtor files for bankruptcy, or a creditor files, based on an execution order that has remained outstanding for sixty days.
- A bankruptcy trustee is appointed and takes control of the debtor.
- Legal actions against the debtor are suspended.
- Creditors (including parties with ownership claims against property held by the debtor) are put on notice to submit evidence of claims.

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<sup>25</sup> In the Federation, most banks report on a monthly basis their clients whose accounts have been blocked because of inability to pay debts as they come due. For instance, in the April 8, 2003 issue of the Official Gazette, Raiffeisen Bank (the largest bank in Bosnia) reported that 371 of its clients had accounts that had been blocked for more than 90 days. The information on these entities is limited, however, to only the name of the entity, its address, and its account number.

<sup>26</sup> Interview of Lourdes Borrell of the Customs and Fiscal Assistance Office to Bosnia and Herzegovina (April 17, 2003).

<sup>27</sup> RS Official Gazette, No. 67/02.

<sup>28</sup> RS Official Gazette, No. 64/02.

<sup>29</sup> Given that it is supposed to apply to solvent debtors, there are fewer safeguards and procedures built into the Law on Liquidation. The primary concern with the Law on Liquidation is that insolvent debtors may attempt to use it to conduct a liquidation without the safeguards found in the Law on Bankruptcy Proceedings. Addressing this risk should be the primary focus of the training and implementation with respect to this law.

- Liabilities are established. Creditors failing to file in time have their claims extinguished.
- The bankruptcy trustee sells the debtor's property **or** a reorganization plan is developed and voted upon by the creditors.

75. Some officials in the RS Government have expressed concerns about the lack of special provisions in the Law regarding state owned enterprises, and the World Bank has raised flags over the extent that workers claims should enjoy preferential status. Nonetheless, on the whole, the Law on Bankruptcy Proceedings is a vast improvement over its predecessor legislation and appears quite workable, at least on paper.

### **Bankruptcy Implementation**

76. The immediate need is to focus on the implementation of the Law. While further amendments may become necessary, these should be supported only after the Entities have gained substantial experience implementing it.

#### Gathering, Maintaining and Distributing Information

77. Bankruptcy is a multi-party, information-intensive process. The parties to a proceeding need to be sufficiently informed of issues arising in a proceeding in order to protect their rights and participate effectively. The means by which parties receive information in civil litigation is usually inadequate for a bankruptcy case. Mail is expensive and slow. Publication in the Official Gazette is subject to significant delay. And notices posted on the court house information board are inherently limited. What is needed is a methodology for collecting information on bankruptcy cases (particular filings, offerings of property, announcements as to creditor meetings) and making it more readily available, perhaps on a website. Such a site could also provide information on bankruptcy trustees and the bankruptcy process in general.

#### Initial Development of a Core Bankruptcy Curriculum

78. Bankruptcy training in Bosnia and Herzegovina has been quite limited. At the law faculty level, bankruptcy merits only a brief mention in the third year of a four-year course.<sup>30</sup>

79. In the Federation, a private consulting company offered a training program to approximately 130 potential bankruptcy trustees in 2001. In the RS, no training appears to have been offered in recent years. Trustee applicants however, are expected to be offered some training funded by the Quick Impact Facility.<sup>31</sup>

80. Court officials, as well as various donors, have made clear the need for training in this area. A core training program for the various participants is needed in (1) basic corporate finance, (2) bankruptcy concepts, and (3) the intricacies of the new Law. Beyond that, the curriculum should be tailored to the differing roles of trustees, judges, and creditors, with particular emphasis on skills needed to perform their particular tasks. Members of the combined drafting group that developed the Law on Bankruptcy Proceedings could provide useful input. Further, in the Federation, several individuals have accumulated significant experience liquidating banks. Although bank liquidation

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<sup>30</sup> Professional training for law is provided primarily as an undergraduate degree program.

<sup>31</sup> A German attorney living in Banja Luka, with extensive experience in the region and with the German bankruptcy law, Mr. Georg Blomeyer ([g.blomeyer@t-online.de](mailto:g.blomeyer@t-online.de)), is providing the training.



differs somewhat from conventional bankruptcy, there are numerous areas where the two regimes overlap (for instance on how an administrator takes over a company pursuant to a court order). Lessons from this experience would be particularly useful.

#### Training of Bankruptcy Trustees.

81. The most crucial and immediate training needs involve those for bankruptcy trustees. Pursuant to the Law on Bankruptcy Proceedings, the RS Ministry of Justice has published its program for examining and certifying persons who wish to serve as trustees.<sup>32</sup> The RS MOJ will establish a three person Board of Examiners, who will administer an oral examination to applicants. The subject areas are (1) bankruptcy law, (2) civil and commercial law, and (3) accounting and finance. Licensed lawyers need not be tested in civil and commercial law. Licensed accountants need not be tested in accounting and finance.

82. The RS certification process requires no formal training or written exam. Applicants need only have a university degree in law, economics, or technical science,<sup>33</sup> as well as five years of relevant experience.

83. Within this certification regime, it will be important to ensure that the certified trustees have both the practical and theoretical knowledge sufficient to at least work their way through their initial bankruptcy cases, and that the oral examinations should sufficiently test for these skills. The Board of Examiner's expected questions will influence the training potential trustees will demand. For instance, if the Board were known to give applicants a fact pattern to work through and solve, this will influence the type of training that the applicants will demand. In short, innovative questions will increase demand for innovative training.

84. The MOJ should thus seek out an intensive training program for the Board of Examiners, perhaps in a country within the region, to increase their appreciation of the types of skills that bankruptcy trustees will require. Emphasis should be on formulating "case-study" type questions that could be used during the Examinations. With the Board's approval, these types of questions could then be made publicly available.

85. Further, consideration should be given to arranging for civil law and commercial law training to non-attorneys and financial and accounting training to non-accountants. Several training organization competent in these areas are operating in the country.<sup>34</sup>

#### Training of Other Participants in Bankruptcy Proceedings

86. Judges, creditors, and attorneys will likewise play crucial roles in bankruptcy proceedings. They need to be thoroughly versed in bankruptcy proceedings and their particular role therein.

87. The training needs of these participants are described below:

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<sup>32</sup> Rulebook on the Program for Taking an Exam for Acquiring the Title - Bankruptcy Trustee, (RS Official Gazette No. 6/03).

<sup>33</sup> Technical science would include engineering and architecture.

<sup>34</sup> See [www.revicon.info](http://www.revicon.info) for the site of a particularly active professional training organization operating out of several cities in the Federation.

*Commercial Division Judges:* The judges appointed to the newly formed commercial divisions will oversee bankruptcy cases. As noted earlier, it is estimated that approximately 15 judges will be appointed to these divisions in the RS and 30 judges to similar positions in the Federation. They are likely to be selected only by the end of the third quarter of this year.

A Judicial Training Institute, recently founded in each Entity, is responsible for training judges. The Institutes, however, have yet to become fully operational. As an alternative, the judges' associations in each Entity have provided training logistics and support.

Judges need exposure to general bankruptcy principles and the bankruptcy law itself. Much of the material used for training bankruptcy trustees on these matters could be used for judges. Beyond that, however, the training should focus on managing cases and resolving disputes as they arise. Particularly effective would be a series of fact patterns that the judges would have to discuss and issue rulings thereon.

Finally, it should be noted that the judges in the courts of second instance will hear appeals on decisions regarding bankruptcy. They could benefit from a more narrowly focused program on bankruptcy law and policy.

*Creditors:* Creditors will play a greater role in bankruptcy proceedings under the new legislation. Their active and informed participation is crucial as they are the key stakeholders in a bankruptcy case.

Potential target audiences include bank personnel and other employees of credit-granting organizations. The association of bankers in each Entity, as well as SEED (with respect to credit-granting SMEs) could provide training assistance.

As with judges and trustees, the training should initially focus on general concepts and an introduction to the law. The remainder of the training should focus on how creditors can protect their rights by active participation in the proceedings (for instance, by serving on the board of creditors in a particular case). Particular emphasis should be on the rights of secured creditors and evaluation of reorganization and liquidation plans.

*Attorneys:* Beyond general concepts and an introduction to the law, training for attorneys should focus on the particular legal problems faced by creditors, bankruptcy trustees, and the debtor's management. Some of the material for this training is likely to overlap with the other training efforts. The Bar Associations of the two Entities are likely to be able to provide training assistance.

#### Clarification of Rights and Obligations of Institutions other than the Court that are Involved in Bankruptcy Proceedings

88. The initiation of bankruptcy proceedings with respect to an enterprise will have subsequent effects with several institutions, both private and public. The rights and responsibilities of these institutions need to be further clarified. To name several:

- *The various property and business registries: with respect to their obligations to record official notices that an enterprise has come under bankruptcy proceedings;*
- *Insurance companies: with respect to their ability to offer fidelity bonds to bankruptcy trustees;*
- *The postal service: with respect to its obligations to stop the mail of the debtor enterprise at the request of the bankruptcy trustee;*
- *The tax authorities and other government creditors: with respect to how they will act as a creditor of the debtor;*
- *Banks: with respect to their recognition of the authority of the bankruptcy trustee;*

- *Public utilities: with respect to their obligations to continue to provide service to the debtor regardless of the total amount of arrears accrued before the bankruptcy petition was filed;*
- *The Ministry of Justice: with regard to the establishment and adjustment of fee scales for bankruptcy trustees.*

#### Clarification of Status of Ongoing Bankruptcy Cases

89. There are currently hundreds of bankruptcy cases filed in the courts, though only a few are active. These cases will likely become the responsibility of the commercial divisions upon the appointment of the respective judges. The commercial courts need to develop an effective means of disposing of inactive cases and treating the active ones in accordance with the Law on Bankruptcy Proceedings.

#### Establishment of an Association of Bankruptcy Trustees

90. The formation of an association of bankruptcy trustees should be encouraged. Such an association could facilitate training and education with respect to international best practices regarding bankruptcy. It could also support the development of appropriate criteria for regulating trustees, taking on greater responsibility for self regulation over time.

#### Development of Implementation Resource Materials

91. Resource materials should be developed, including: (1) a manual for trustees, (2) a reference book for judges, and (3) a handbook for creditors. As demonstrated by the reliance of bank liquidators on a bank liquidation manual developed by USAID, such publications can prove to be extremely useful. Much of the material for these publications could be derived from the materials used in the initial training sessions.

#### Ad Hoc Assistance to Creditors and Trustees in Ongoing Proceedings

92. Creditors in bankruptcy proceedings could benefit from guidance with respect to particular cases.

#### Follow-Up Training

93. A year of implementing the Law on Bankruptcy Proceedings is likely to yield significant information as to how practices (and perhaps the law itself) could be adjusted to improve implementation. Evolving practices should be the focus of follow-up training for trustees, creditors, judges, etc.

#### Advocacy of Further Legal Reform

94. Based on the experiences gathered through the initial year of implementing the law, the association of trustees and the association of banks in each Entity should develop amendments to the Law on Bankruptcy Proceedings and implementing regulations.

#### Support for Debtor-Initiated Reorganization Attempts

95. The Law on Bankruptcy Proceedings, like most modern bankruptcy laws, contains provisions that allow for the formulation and submission of a reorganization

plan to the court and creditors for approval. Such a plan may be submitted in a voluntary proceeding (initiated by the debtor) or an involuntary proceeding (initiated by creditors).

96. A creditor-initiated reorganization effort is likely to be extremely difficult to implement without the cooperation of the debtor's owners and management. It is simply too easy to hide information or otherwise frustrate the work of the bankruptcy trustee. A reorganization is more likely to succeed if the debtor's owners and management initiate a voluntary proceeding and work with the creditors on a reorganization plan in a constructive and cooperative manner.

97. Such reorganization attempts are likely to occur and succeed only if owners and managers of distressed companies understand how to utilize the Law on Bankruptcy Proceedings to negotiate a plan acceptable to the creditors that provides them with some retained interest in a reorganized company. Successful implementation of the Law will require providing these skills to managers, financial advisors, and owners (including the privatization investment funds). Caution, however, should be exercised in starting this effort too early, before the courts, bankruptcy trustees, and creditors have developed sufficient competence in the Law to protect their interests *vis a vis* the debtor.

## **Bankruptcy of Insolvent State-Owned Enterprises where Conventional Privatization Measures have Failed**

### **Background**

98. Given their distressed financial state, large, primarily state owned companies will likely make up the majority of companies falling under bankruptcy proceedings during the initial years of the Law's implementation. The Law on Bankruptcy Proceedings does not distinguish between the treatment of state-owned and non-state-owned companies. This is likely to lead to a conflict between the current policies favoring conditional privatizations (or continued state ownership in some cases) and the need to protect creditors and respect the norms established in the Law on Bankruptcy Proceedings.

99. It is thus possible that courts will fail to effectively implement the Law on Bankruptcy Procedures with respect to SOE debtors in the face of conflicting public policies and state pressure. However, if implemented correctly, bankruptcy proceedings could prove to be a very effective means of privatizing companies where conventional privatization has failed.

### **Privatization through Bankruptcy**

100. The relevant authorities need to manage the insolvency and bankruptcy of state owned enterprises, and should be encouraged to promote the privatization of at least one enterprise in each Entity through bankruptcy proceedings.

### **Development of an Approach to the Bankruptcy of State-Owned Enterprises**

101. The relevant authorities in each Entity must consider the potential challenges posed by the likely initiation of bankruptcy cases against state owned enterprises. Proposed solutions should take into account (1) the need for relatively speedy privatization, (2) the limited capacity of privatization agencies in restructuring companies, (3) the rights of creditors of the state-owned enterprises, and (4) potential benefits of avoiding a piecemeal liquidation.

102. The USAID Privatization Project has developed an approach involving a pre-packaged reorganization plan, where the state owned shares of the debtor would be sold in a competitive tender (without employment or investment conditions). The proceeds from the sale would be used to pay off the debt of the enterprise with the unpaid portion being extinguished by a judicial order. This approach should be discussed with the relevant privatization authorities.

Encouragement and Support of the Privatization of at Least Two Enterprises through Bankruptcy Proceedings.

103. The privatization of state owned companies through bankruptcy should be encouraged.

Reorientation of Public Opinion with Respect to Bankruptcy.

104. The press coverage of bankruptcy issues tend to focus on the sensational effects of bankruptcy and very little on the potentially positive role it can play in the economy. For instance, as the Law on Bankruptcy Proceedings was being debated in Parliament in March 2003, the press quoted widely the prediction that 100,000 workers would lose their jobs as the result of the implementation of the new bankruptcy law. No mention was made that many of these jobs were just shadow jobs or that the enterprises in question had ceased operations already.

105. The public, as well as government decision makers, need to develop more realistic views of the role that bankruptcy can play in a market economy. The USAID Privatization Project for Strategic Enterprises and the press office of the Office of the High Representative are planning public relations initiatives in the area of privatization. Consideration should be given to expanding these efforts to include public education concerning bankruptcy.

## **BUSINESS COMMUNITY INVOLVEMENT IN POLICING AND SUPPORTING THE COMMERCIAL COURT DIVISIONS**

106. As has been widely recognized, the business environment in Bosnia and Herzegovina has suffered as a result of the inadequate performance of the judiciary. While many of the judicial reforms discussed in this report have the potential to improve judicial performance, these alone are insufficient. Non-governmental organizations representing the business community can improve judicial performance, reduce corruption and build public support for continued judicial reforms.

### **The Business Community within Civil Society**

107. The local business community in Bosnia and Herzegovina has only recently begun to involve itself in formulating substantive laws and regulations affecting its interests. For several years, such activity has been less than robust, partly due to the difficulties in working closely and communicating with the international community. Improvement in this effort is further complicated by the recent reforms regarding the chambers of commerce. The system that required mandatory membership in a chamber is being replaced with a voluntary one. The chambers, at least temporarily, may find themselves distracted with membership drives at the expense of business law advocacy.

108. The business community, however, took a positive step forward with its participation in the Bulldozer Committee, where businessmen offered ideas for reforms

of substantive laws hampering economic activity. A similar effort needs to start with respect to commercial law enforcement.

### **Opportunities for the Business Community to Monitor and Enhance Court Performance**

109. In theory, the business community has recognized its role in the formulation of business laws.<sup>35</sup> It is not such a great leap to participate in their proper enforcement.

110. As an initial measure, the business community should reach out to the court system—specifically with respect to its natural counterpart—the commercial division judges. A business-judicial council could be formed to oversee and facilitate some of the initiatives described below.

#### **Providing Direct Assistance to the Commercial Division Courts**

111. As a sign of goodwill, the business community could raise funds for the purchase of needed tools for the judiciary. For instance, the business community could supply each commercial court judge with a CD-ROM containing all the relevant business laws and judicial decisions.<sup>36</sup>

#### **Reducing Docket Congestion and Corruption through Collective Action**

112. The business community could establish a docket decongestion and judicial integrity pact, where the signatories agree to (a) use alternative dispute resolution whenever possible (in order to reduce the number of disputes reaching the judicial system) and (b) require the law firms they hire to pledge to forego any corrupt action on their behalf (with the penalty being the forfeiture of outstanding legal fees). Participation in the pact could be made a symbol of good corporate citizenship. Members could be listed on the website(s) described below.

#### **Publishing Statistics on Judicial Performance**

113. Several websites serve the business community in Bosnia and Herzegovina. Any one of them could likely be expanded to:

- *Provide meaningful statistical information on the performance of courts and judges vis a vis each other.* This will subject courts and judges to a subtle but powerful incentive to perform.
- *Contain a database of decisions of commercial division judges.* This would encourage judges to write better decisions. It would also provide attorneys, judges, and businesses with more information as how to interpret a particular statute, etc.<sup>37</sup>
- *Provide data on judicial appraisals of values of property under enforcement proceedings as compared to their actual sales prices.* This would expose

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<sup>35</sup> For instance the Chamber of Commerce for the Federation of Bosnia and Herzegovina includes legislative drafting and advocacy as one of its main functions. See [www.kfbih.com/eng/competence.htm](http://www.kfbih.com/eng/competence.htm)

<sup>36</sup> These are available from private vendors. Though expensive when purchased individually, the price would likely fall considerably if purchased in bulk.

<sup>37</sup> The website should publish decisions that are not otherwise being provided by private parties.

appraisers whose estimates consistently overshoot market values. It would also promote greater transparency with land values.

### **Facilitating Interaction between Businesses, and the Legal Community/Courts**

114. The same business community website(s) could be expanded to:
- *Provide information (instructions, forms, contact information) and references to information designed to enhance the ability of businesses to interact with the court on matters for which an attorney may not be legally or practically necessary.* Many studies have found that attorneys tend to lengthen proceedings rather than make them more efficient. Enhancing the ability of parties to resolve issues without attorneys will reduce legal costs as well.
  - *Provide information designed to enhance the ability of businesses to choose an attorney, monitor his or her performance, and to take appropriate action where such attorney fails to perform in a reasonable manner.* This would assist businesses in policing attorneys.
  - *Provide information designed to encourage businesses to report instances where the judicial system fails to provide reasonable justice.* This would assist businesses in policing judges.
  - *Serve as a notice board to supplement the publication of judicial decisions, where such enhanced notice would assist businesses and other persons in protecting their rights.* Often times, the notice provided by the Official Gazette is simply inadequate in terms of timeliness and/or circulation. A website could supplement these notices.
  - *Provide information designed to enhance the ability of creditors to participate in bankruptcy proceedings.* For instance, rather than having a reorganization plan mailed to individual creditors, such creditors could simply receive notice that the plan is available on a particular website.

### **Encouraging Broader Public Support for an Effective Judiciary**

The business community website(s) could:

- *Provide information designed to garner public support for increasing resources available to the courts.* For instance, support expenditures per judge in the various cantons could be compared. This information could be used by reformers to argue for greater support for judges in a particular canton.
- *Provide information designed to increase public understanding and acceptance of bankruptcy procedures.* The site could provide a platform for explanatory materials, success stories, etc.
- *Provide information designed to increase public support for amendments to government, laws, regulations and policies that would further improve the environment for enforcing commercial laws in a speedy, effective and predictable manner.* This would facilitate greater involvement of civil society in legal reform efforts.

### **Feasibility of Internet Based Approaches**

115. In developing some of the Internet initiatives, the business community would have to take into account four factors: (1) existing law related sites in Bosnia and Herzegovina, (2) local Internet use, (3) access to information, and (4) economic viability.

#### Law Oriented Sites in Bosnia and Herzegovina

116. There are numerous law related sites in the country. None have the focus suggested here. The closest is the website of the Sarajevo cantonal court, [www.ksudsa.net](http://www.ksudsa.net), which publishes basic information about the court, as well as statistics on cases received and disposed. The two other sites, both private initiatives: [www.cob.net/sudskapraksa](http://www.cob.net/sudskapraksa), [www.zakonibih.com](http://www.zakonibih.com) primarily focus on selling CD-ROMs containing legislation and/or decisions of the Supreme Court.

#### Internet Use in Bosnia and Herzegovina

117. By all accounts, Internet use is low in Bosnia, even when compared to the region. The general consensus is that two percent of the population uses the Internet. Beyond that, few, if any, market surveys or official statistics provide guidance.

118. It is possible, however, to draw some conclusions about bankers and attorneys, two of the main groups within the website's target audience. No one doubts that the personnel at the larger banks in the country have Internet access through their offices. Attorney use is harder to measure. The Federation bar association's directory of attorneys does not show email addresses. Discussions with the vendors of legal software indicate that computer use, let alone Internet use is extremely low among practicing attorneys.<sup>38</sup>

119. The slow adoption of computers by practicing attorneys stands in marked contrast to law students in the country. Virtually all of them are computer and Internet literate. This bodes well for the Internet usage of young attorneys, another obvious target audience.

120. Another directory, that of trainer-consultants in Bosnia (published by SEED on their website)<sup>39</sup>, indicates high Internet use among these professionals. Approximately 85 percent of the 120 individuals in this directory had email addresses.

121. It may be necessary in the near term to supplement Internet publication with a hard copy publication for circulation within the business community.

#### Access to Relevant Information

122. Information that might be put on a business community website, such as court statistics, judicial decisions of lower courts, or prices obtained at foreclosure sales, is currently not readily available. Any Internet effort with the courts would require an information gathering component in order to succeed.

123. Access to this information can be obtained as a *quid pro quo* for the business community's support for the commercial divisions. Law students could handle the collection of this information until more formalized arrangements are established.

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<sup>38</sup> Interview of Miralem Porobic (April 28, 2003). Interview with Semir Guzin (April 25, 2003).

<sup>39</sup> See [www.ifc.org/seed](http://www.ifc.org/seed).



### Sustainability

124. It is highly unlikely that the site(s) envisioned in this report could operate without some donor support. Nonetheless, given its target audience and focused issues, the site might prove attractive in the future to law firms looking to advertise their services. Further, some of this information might find better homes as various institutions develop. Much court information might eventually be published by the courts themselves. Information regarding bankruptcy might eventually be published by an association of bankruptcy trustees.

### **CONCLUSION**

125. Recent legislative initiatives Bosnia and Herzegovina have significantly improved the legal framework facing secured creditors as well as parties attempting to enforce claims in bankruptcy proceedings. However, unless the new laws are implemented and enforced properly and fairly, they will not yield their intended benefits.

126. First, judges, referees, bankruptcy trustees, and other relevant court and registry officials need to be trained in the meaning, intent, and application of the new laws. Similar training should be offered to lawyers and other stake-holders. Appropriate reference guides based on the training materials should be developed and distributed.

127. Second, the courts must be provided with the resources necessary to accomplish their assigned responsibilities. Particular attention must be given to the allocation of resources to the enforcement departments who retain sole authority for the enforcement of mortgages and pledges, as well as all civil judgments.

128. Third, information concerning bankruptcy and enforcement proceedings must be made readily accessible to those with an interest in the proceedings. Property sales and prices must be made similarly transparent. The creation of a publicly searchable database of bankruptcy cases, pending foreclosure sales, and other developments affecting creditor rights should be promoted.

129. Fourth, bankruptcy should be demonstrated and promoted as an effective means of privatizing financially distressed state-owned enterprises.

130. Fifth, the public needs to be educated generally concerning the importance of bankruptcy and the effective enforcement of creditors' rights to economic development.

131. Finally, the business community, including bankers' associations, the chambers of commerce, and the like, need to become more engaged in the process of advocating law reform, monitoring judicial performance, and participating constructively in commercial law enforcement proceedings.

## APPENDIX 1 – INTERVIEWS

Official(s)	Organization
Neil Murphy and Martin Slough	World Bank
Sljivo Fahrudin, Director	Livnica Sarajevo
Steve Farkas, Director	USAIDBF
Boris Maslo, Attorney	USAIDBF
C. Dale Wilson	USAID Bank Supervision Project
Andreas Clausing and Dr. Ulrich Solte	GTZ
Yair Baranes	USAID Pledge Registry Project
Eija Iivonen	Independent Judicial Commission
Patrick Wujcik	ABA CEELI
Sam Greer (by telephone)	USAID Tax Administration Project
Dzevad Gazibegovic	Liquidator of BH Bank
Jean Vollbrecht and Anne Marie Gayle	Office of the High Representative
Pat Wujcik and Eija Iivonen	ABA/CEELI & IJC
Aida Sebic	Volksbank
Mark Dietrich	Independent Consultant for USAID
Stephen Bryant	Norwegian People's Aid
Dzemaludin Mutapcic, Asst. Minister of Justice	Federation MOJ
Mijo Misic, General Secretary	"Federation Banking Agency" – Gospodarska Bank
Mr. Dragan Damjanovic Deputy Director	VB Bank, Banja Luka
Stevan Demitrijevic	Razvojna Banka, Banja Luka
Judge Nedjeljko Milijevic	Basic Court, Banja Luka
Ms Gordana Dubinovic & Mr. Slavisa Rakovic	Nova Bank, Banja Luka
Judge Draginja Djukic	Basic Court, Banja Luka
Lejla Dragnic, Program Coordinator for Bosnia and Herzegovina	SEED
Mihret Dizdar and Zelko Ricka	Revicon, d.o.o.
Zlatan Jugo, Liquidator/Consultant	International Commercial Bank, dd
Vojisla Puskarevic	Raiffeisen Bank
Judge Asim Kanlic	Sarajevo Cantonal Court
Dzemaludin Mutapcic	Federation Ministry of Justice
Lourdes Borrell	CAFAO
John Peyton	HJPC
Georg Blomeyer	Independent Consultant/Attorney
Rajlic Milorad	Official Court Expert
Judge Asaf Daupovic	Sarajevo Municipal Court 1, Enforcement Department
Semir Guzin	Practicing Attorney
Judge Indira Karahodzic	Sarajevo Municipal Court 2, Enforcement Department
Miralem Porobic	Practicing Attorney
Kasim Zulum,	Court Expert-Appraiser
Faris Njemcevic, Ibrahim Meninovic	PROF Privatization Investment Fund

Official(s)	Organization
Hasan Jakupovic	Federation Chamber of Commerce